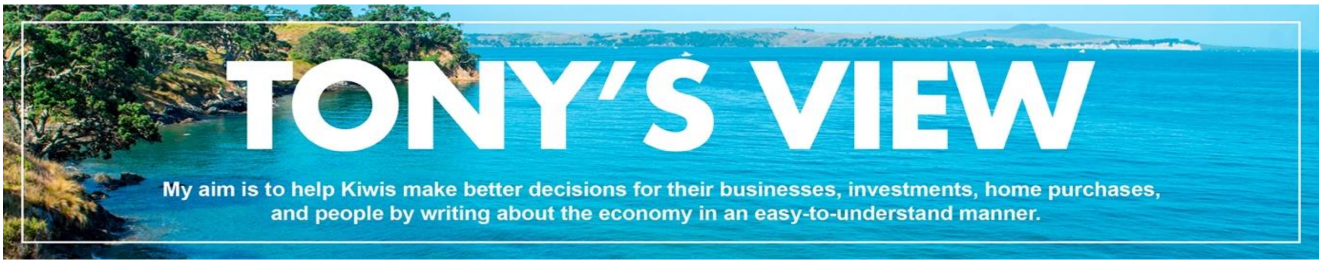

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20 reasons to keep perusing listings

Last week I wrote a list of 13 reasons why a house buyer might want to sit on their hands doing nothing at the moment. As promised, this week I look at a list of reasons why remaining engaged with the housing market, keeping an eye on the rapidly rising stock of listings and improving purchase prices would be a good idea, and why bargains will not be prolific this cycle.

Rising construction costs

It is getting more and more expensive to build a house in New Zealand – a 21% increase over the past year being recently reported by one group involved in such things. As construction costs go up more and more people will switch towards looking for a property among listings of existing ones rather than getting a new one built.

This process will be enhanced by the increasing frequency with which media are running stories about construction projects going under.

Social housing demand

Government agency Homes & Communities is looking to expand the number of social houses in New Zealand, and it is likely that as developers increasingly face financial stress they will pick up some extra stock.

One thing to note is that the OECD average proportion of housing stock which is social housing is about 8%. NZ is around 4%. If house prices were to fall 20% our proportion would still be 4%, and if they fell right back to where they were before the pandemic the proportion of our housing stock which would be social housing would still be 4%.

Falling house prices will not lead to better outcomes for social housing and the pressure on the government to purchase and arrange construction of extra social housing will run for decades.

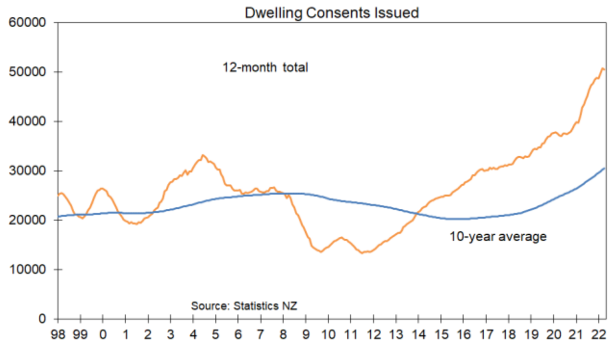
Falling construction

We have had a building boom driven by record low interest rates, a mistaken belief that shortages of property exist all throughout New Zealand, encouragement by every man and his dog for as much construction as possible to be done, and a non-lasting surge in net migration inflows from 2015 leading to incorrect predictions of future population growth.

But many inexperienced, under-capitalised and over-optimistic developers have been drawn into the sector. They have paid too much for land and have no experience in how to professionally handle working with consenting authorities let alone the biggest shortage of materials and staff that we have ever seen.

There is a well established relationship between changes in dwelling sales and changes in consents being issued for new construction. A story about to begin is a large falling away of new consent issuance.

Initially the negative factors driving this big decline in consent numbers will dominate sentiment. But eventually a realisation will dawn that the boom in new dwelling supply will be nowhere near the magnitude implied by the likes of the over 50,000 consents issued in the past year.



We have yet to get through the phase when people ask themselves if there might be an over-supply of property. But after that will follow an eventual focus again on a deficiency of construction.

Migrants getting back into NZ

With the borders reopening we will see migrants able to make their way into New Zealand. The risk is people over-estimate the number who will come our way given the strong demand for labour in higher paying countries. But the rising flow will nonetheless slowly introduce a new source of house demand over time.

200,000 special residency visas

The government has granted migrants in NZ on temporary work visas the ability to apply for a residency permit. It was envisaged that 165,000 might do so but it looks like the number will exceed 200,000.

Not all of these people will immediately purchase a property now that they are legally able to. But at some point, when the cycle looks like no longer falling the residency granted to these people will be cited as a reason why prices will move back up again.

Property as an inflation hedge

Inflation is running at 6.9%, forecasters offshore are revising upward their inflation predictions, oil prices continue to climb higher, and there is open talk of stagflation. While the necessary forces are in play to suppress inflation back below 3% in New Zealand we cannot really know how long this will take. No-one has a model which works any longer for predicting such things.

With this much uncertainty and risk it would not be surprising if a large number of people who might otherwise be cautious about prices falling for their investment properties and sell them instead decide to hold them as an eventual hedge against inflation yet to come.

In fact, the more the generalised rises in consumer goods prices the greater the simple nominal support for house prices.

Homes going back to Airbnb use

Articles are already appearing in the media about properties being placed back in the pool of short-term rentals for foreign visitors. As the pool of rentals dries up rents will rise and additional encouragement will be provided to people to try and buy a property rather than keep renting.

National would restore old tax rules

The National Party have stated that when they get re-elected (2023 or 2026) they will take the brightline test down from ten years to the original two years, and fully restore the ability of investors to deduct interest expenses against rental income when calculating tax obligations.

The closer we get to the election and perhaps the more the public look for change the greater will be the incentive to investors to hold onto their properties and to buy more.

Rents are rising

People often make a big thing about renting sometimes being a better option than buying. This strategy has failed for virtually all those who have followed it – often on the advice of analysts not understanding the factors causing prices to jump compared with incomes. I tend to steer well clear of comparisons of renting versus buying because they are two very different things – one short-term and the other a muti-year or decade commitment.

There is some evidence that a few investors are placing empty properties on the market to rent now that they cannot sell them easily for a profit. But it pays to keep in mind that only some 4% of properties sold over the past year have been purchased less than two years earlier, so the numbers involved here are likely to be very small.

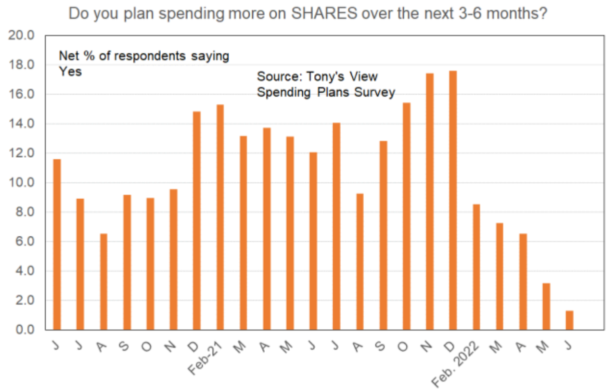
Instead, we have growth in new house supply about to surprise on the low side as developers fail to act on consents granted, as dwellings go back into the holiday rental pool, and costs for landlords rise rapidly.

Rents are rising rapidly, and it will take the mother of all net migration outflows to substantially dent this march of rental costs upward.

Bank deposit rates won't rise much

Banks are flush with deposits courtesy largely of the Reserve Bank's excessive money printing operations over the past two years. Our central bank over-reacted to the pandemic and banks have little need to offer high deposit rates in order to attract the funds needed to back domestic lending to you and me.

Lack of attractive interest rates acts as a disincentive for investors to sell their properties and place the gained funds in a bank. They might sell and invest in a diversified portfolio of equities. But sharemarkets are wobbly and my monthly Spending Plans Survey shows people's general plans for buying shares have declined.

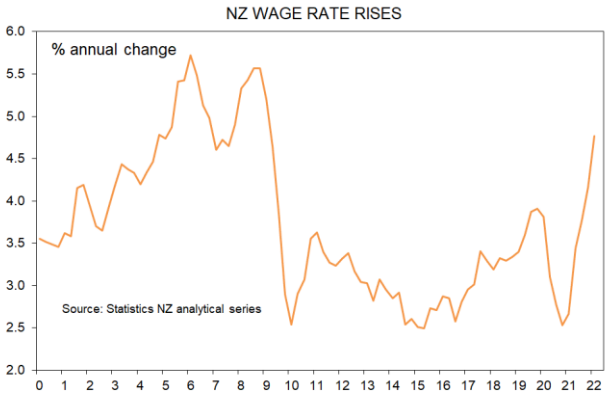


The long-term price trend is up

Many people like to believe that we will return to the old days when average house prices were three times incomes. They won't for a large number of reasons which I have been citing since late-2008. On average NZ house prices have risen 7% a year since 1992. Going forward the average is likely to be closer to 5% due to loosened building regulations. The surge in prices associated with the pandemic is an aberration which is currently unwinding. Once this process is complete the new/old trend will re-establish itself and the difficulties buyers have had raising a deposit and finding a property will return – maybe come 2024-25.

Wages growth is accelerating

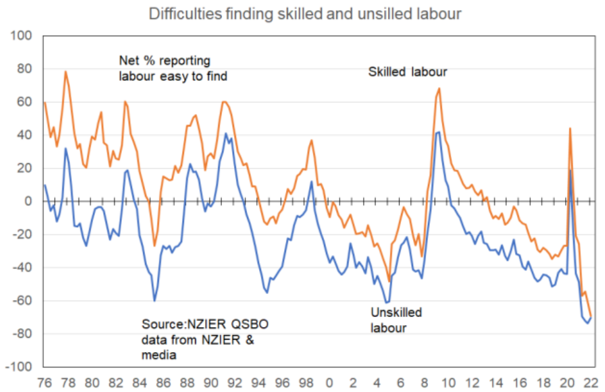
Wages may not be keeping up with inflation, but their rate of rise is lifting. The long-term average rate of increase in NZ wages is about 2% above the inflation rate and that dynamic is likely to return within two years time.



The current pressures on budgets from soaring inflation exceeding inflation will pass and when that happens many people will return to the housing market.

Job security is high

The unemployment rate is 3.2% and likely to fall further. According to publicly available information the NZIER's measure of the difficulties which businesses are experiencing in finding skilled and unskilled labour are at record or near record levels.

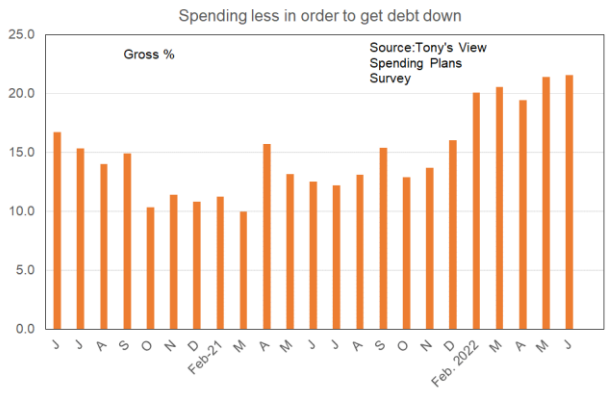


High test mortgage rates used

It is certainly true that many people who borrowed money last year will see the interest portion of their weekly repayments more than double as their mortgage rate rises from below 2.5% to over 5%. But banks tested almost everyone on their ability to pay a mortgage rate above 6%.

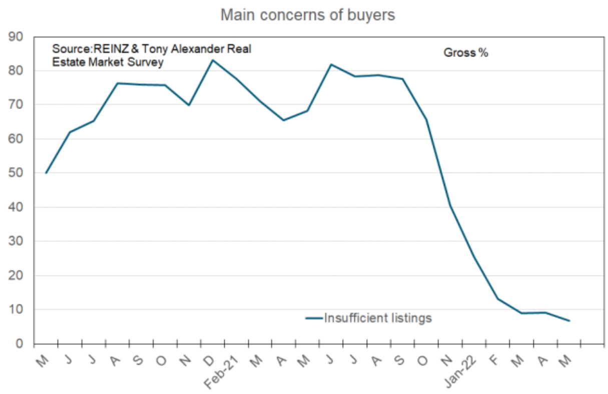
This means there will be only a few people in the situation of paying more than they already proved they could service. This does not mean there won't be an impact, however. In their efforts to keep servicing their mortgage large cutbacks are likely to be made in other areas of spending.

From my monthly Spending Plans Survey, we can see a rise in the proportion of people saying they plan spending less in order to try and get their debt levels down.



Listings becoming plentiful

The biggest concern which buyers have long expressed is that there are not enough listings. Now stocks are running 80% ahead of a year earlier and this concern has faded away to virtually nothing.



The range of choice facing buyers now means that for many this is exactly the time they should be advancing their home hunting plans rather than shelving them until they think prices hit their lows. Good luck picking that – I can't.

Real estate agents work for free for you!

Real estate agents are paid by the seller, not the buyer, and with so many properties to pick and choose from very few buyers will be hiring agents to scout out a property for them. That particular part of the real estate market will be dying more quickly than overall agent revenues.

If you are a buyer then you are the most valuable item in the real estate market now. You won't have to make too many positive facial expressions or body language moves indicating a desire to buy to have the agent actively working on the vendor to get them to discount their price, accept a very short or long settlement date, provide a lot of free property assessment information and documents, and accept conditions if an offer is made.

We have passed peak credit crunch

From July 7 the CCCFA rules will officially loosen and banks can undertake lending without the fear of being fined $200,000 each at senior management and director level should it be determined that they had engaged in irresponsible lending. The changes to the CCCFA from December 1 naturally made bankers so fearful of making a mistake according to someone else's vague subjective definition that they sharply reined in their lending criteria.

Credit will not flow loosely from July 7, but things will improve for borrowers who do step forward with $5mn in assets asking for their credit limit to be raised a few grand.

For many borrowers the problem is not the CCCFA but reduced availability of low deposit lending. The next change in LVRs is likely to be an easing, possibly before the end of the year.

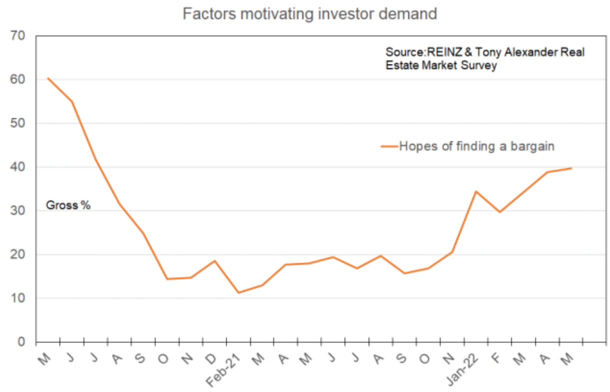
Housing markets move in cycles

We can't pick the timing of the tops and bottoms and can only guess usually very inaccurately as to how far prices will rise and how much they will fall or rise at a slower pace. But we can observe when behaviour changes and the changes underway currently tell us that the cycle is functioning "normally".

That means an upturn lies down the track and just as those who sold before the peak did well, those who buy before the market turns and the herd chases its own tail again will do well.

Not all buyers are retreating

In the monthly survey of real estate agents I run with REINZ I ask agents what the things are which appear to be motivating investors. Keeping in mind that 50% just reported that nothing is motivating them and their demand is falling, 40% said they are motivated by hopes of finding a bargain. This is up from 17% in October.



Frustrated buyers re-engaging

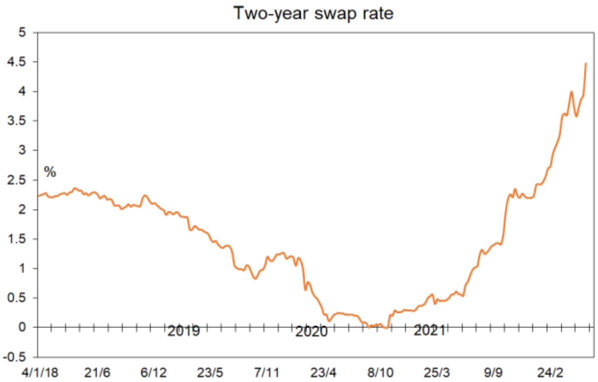
Many people needing to shift home in the past couple of years have not been able to do so because of the market frenzy and the shortage of listings. They still need to move and as listings rise further they will step forward to finally make their transaction, selling then buying or buying then selling in the same market.

If I were a borrower, what would I do?

Nothing I write here or anywhere else in this publication is intended to be personal advice. You should discuss your financing options with a professional.

Wholesale rates higher

The wholesale interest rates which banks pay to lend to you and I at fixed rates have jumped sharply this past week. The one-year swap rate for instance has gone from 3.62% to near 4.15%, the three year rate from 4.02% to near 4.5%%, and the five year rate from 4.02% to also near 4.5%.



The trigger for these rate rises has again been a shift in expectations for monetary policy tightening offshore. In the United States in response to higher than expected inflation the markets are pricing in a more rapid tightening of monetary policy than previously allowed for. The Fed. in fact this morning raised their funds rate by 0.75% - the first time they have done so since 1994. Another 0.75% is likely in a few weeks and with the funds rate now at 1.5% there is some

way to go to reach the Fed.'s pencilled in level of 3.25% come the end of this year.

The markets have swung around to the view that having over-cooked the US economy and being hit by new pricing pressures associated with China's covid strategy and Russia's invasion and blockade of Ukraine, that the Fed. will have to risk recession by acting aggressively.

Tview Premium has additional interest rates discussion.

My current expectation for the one-year fixed mortgage rate in June each year is shown in the first column of the table below. I focus on that rate because there are many people who have fixed one-year repeatedly since 2009 and the strategy has worked very well.

The second column shows what the one-year rate will average over the next 2-, 3-, 4-, and 5-year periods. The last column shows the current best 2 – 5 year fixed rates charged by the lenders I track.

	Forecast 1 year rate	Rolling average rates	Current fixed	
2022	4.85		4.85	1 yr
2023	5.75	5.30	5.19	2 yr
2024	5.00	5.20	5.39	3 yr
2025	4.25	4.96	5.55	4 yr
2026	4.00	4.77	5.79	5 yr

If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 5.30%, three years 5.20%, four years 4.96%, and five years 4.77%.

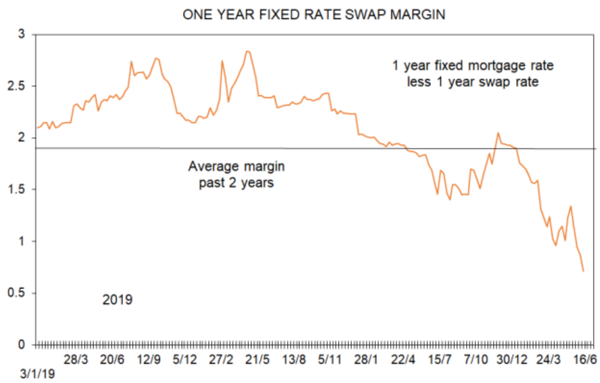
If these forecasts prove correct (I'd give that a 10% probability), rolling one-year fixed will deliver an average rate for the next two years of 5.12%, three years 5.08%, four years 4.87%, and five years 4.70%.

If I were a borrower, what would I do?

I would not fix longer than two years.

To see the interest rates currently charged by major lenders go to www.mortgages.co.nz

Tview Premium contains more interest rates discussion and graphs than included in Tony's View. Here is an example. It shows the bank lending margin roughly calculated, (it's the movements which matter) for one year fixed rate lending.



Links to publications

Tony's View Spending Plans Survey

Spending Plans Survey

Tony's View Business Survey

Business Survey

Tony's Thoughts Vlog

REINZ & Tony Alexander Real Estate Survey

Oneroof weekly column

Handling high interest rates

Handling staff shortages

Handling high cost of living

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

Tony Alexander Regional Property Report

Crockers & Tony Alexander Investor Insights

Investing Insights